17

Medical and Dental Expense Deductions

Tax relief for the high cost of medical care is limited. Medical expenses are deductible only if you itemize and only if you have expenses exceeding 7.5% of your adjusted gross income. Expenses up to 7.5% of AGI are not deductible.

Carefully review the list of deductible expenses in this chapter so that you do not overlook any deductible expenses. Include payments of doctors' fees, health care premiums, prescription medicines, travel costs for obtaining medical care, and eligible home improvements.

If you are married, both you and your spouse work, and one of you has substantial medical expenses, filing separate returns may result in a lower overall tax.

Deductible medical expenses are *not* subject to the 3% reduction of itemized deductions that applies if adjusted gross income exceeds $117,950 ($58,975 if married filing separately).

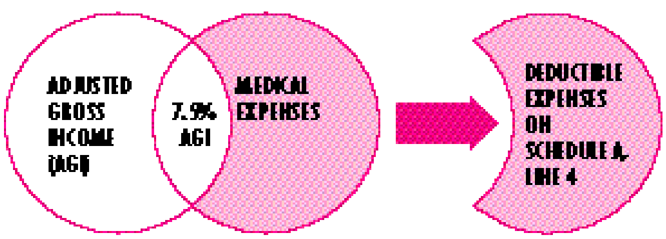
¶17.1 Limitations on Medical Expense Deductions

The tax law provides only a limited opportunity to deduct medical costs for you, your spouse, and your dependents. It sets down these conditions:

1. You must itemize deductions on Schedule A of Form 1040.
2. You may deduct only unreimbursed medical expenses that exceed 7.5% of your adjusted gross income. For example, if your adjusted gross income is $40,000, medical expenses of up to $3,000 are *not* deductible ($40,000 × 7.5%); only expenses over $3,000 may be claimed.

Should spouses file separately? If you are married and both you and your spouse have separate incomes, and one of you has substantial medical expenses, consider filing separate returns. This way the 7.5% floor will apply separately to your individual incomes, not to the higher joint income. To make sure which option to take—filing jointly or separately—compute your tax on both types of returns and choose the one giving the lower overall tax; *see* ¶1.2.

Filing separately in community property states. If you and your spouse file separately and live in a community property state, any medical expenses paid out of community funds are treated as paid 50% by each of you. Medical expenses paid out of separate funds of one spouse can be deducted only by that spouse.



¶17.2 Allowable Medical Care Costs

A deductible medical expense is any cost of diagnosis, cure, mitigation, treatment, or prevention of disease or any treatment that affects a part or function of the body. *See* the checklist on the next page.

However, expenses that are *solely* for cosmetic reasons are not deductible. Also, expenses incurred to benefit your general health are not deductible even if recommended by a physician; *see* ¶17.3.

Medicine and drugs. To be deductible, medicines and drugs other than insulin must be obtainable solely through a prescription by a doctor. Insulin is deductible even though a prescription may not be required. You may not deduct the cost of over-the-counter medicines and drugs, such as aspirin and other cold remedies, even if you have a doctor's prescription.

Special foods. The cost of special foods or beverages is not a deductible medical expense if the food or beverages substitute for those normally consumed.

EXAMPLE

To alleviate an ulcer, your doctor puts you on a special diet. According to the IRS, the cost of your food and beverages is not deductible. The special diet replaces the food you normally eat.

The Tax Court has set its own standard for deducting the extra cost of special foods as medical costs. The test is to show a medical need for taking the special food and the extra cost of the health food over ordinary food. Only the extra cost is deductible.

EXAMPLES

1. Anna Von Kalb suffered from hypoglycemia and her physician prescribed a special high protein diet, which required her to consume twice as much protein as an average person and exclude all processed foods and carbohydrates. She spent $3,483 for food, and deducted 30%, or $1,045, as the extra cost of her high protein diet. The IRS disallowed the deduction, claiming that the protein supplements were a substitute for foods normally consumed. The Tax Court disagreed. The high protein food did not substitute for her usual diet but helped alleviate her hypoglycemia. Thus, she may deduct its additional expense.
2. The Bechers suffered from allergies and were advised by a physician to eat organically grown food to avoid the chemicals in commercial food. The Bechers claimed a medical expense deduction of $2,255, the extra cost of buying organic food.

   The IRS disallowed the deduction and the Tax Court agreed. They did not present evidence that their allergies could be cured by limiting their diet to organic food. That the food was beneficial to their general health and was prescribed by a doctor is not sufficient for a deduction.

Childbirth classes. A mother-to-be may deduct the cost of classes instructing her in Lamaze breathing and relaxation techniques, stages of labor, and delivery procedures. If her husband or other childbirth "coach" also attends the classes, the portion of the fee allocable to the coach is not deductible, nor are costs of classes on early pregnancy, fetal development, or caring for newborns.

DEDUCTIBLE MEDICAL EXPENSES

PROFESSIONAL SERVICES

Chiropodist
Chiropractor
Christian Science practitioner
Dermatologist
Dentist
Gynecologist
Neurologist
Obstetrician
Ophthalmologist
Optician
Optometrist
Orthopedist
Osteopath
Pediatrician
Physician
Physiotherapist
Plastic surgeon; but *see* ¶17.3.
Podiatrist
Practical or other nonprofessional nurse for medical services only; not for care of a healthy person or a small child who is not ill. Costs for medical care of elderly person unable to get about or person subject to spells are deductible; *see* ¶17.12.
Psychiatrist
Psychoanalyst
Psychologist
Registered nurse
Surgeon
Unlicensed practitioner services are deductible if the type and quality of the services are not illegal

DENTAL SERVICES

Artificial teeth
Cleaning teeth
Dental X-rays
Extracting teeth
Filling teeth
Gum treatment
Oral surgery
Straightening teeth

EQUIPMENT AND SUPPLIES

Abdominal supports
Air conditioner where necessary for relief from an allergy or for relieving difficulty in breathing; *see* ¶17.13.
Ambulance hire
Arches
Artificial eyes, limbs
Autoette (auto device for handicapped person)
Back supports
Braces
Contact lenses
Cost of installing stair-seat elevator for person with heart condition; *see* ¶17.13.
Crutches
Elastic hosiery
Eyeglasses
Fluoridation unit in home
Hearing aids
Heating devices
Invalid chair
Iron lung
Orthopedic shoes— excess cost over cost of regular shoes
Oxygen or oxygen equipment to relieve breathing problems caused by a medical condition
Reclining chair if prescribed by doctor
Repair of special telephone equipment for the deaf
Sacroiliac belt
Special mattress and plywood bed boards for relief of arthritis or spine
Splints
Truss
Wheelchair
Wig advised by doctor as essential to mental health of person who lost all hair from disease

MEDICAL TREATMENTS

Abortion
Acupuncture
Blood transfusion
Childbirth delivery
Diathermy
Electric shock treatments
Hearing services
Hydrotherapy (water treatments)
Injections
Insulin treatments
Navajo healing ceremonies (“sings”)
Nursing
Organ transplant
Prenatal and postnatal treatments
Psychotherapy
Sterilization
Radium therapy
Ultraviolet ray treatments
Vasectomy
Whirlpool baths
X-ray treatments

MEDICINES AND DRUGS

Cost of prescriptions only; over-the-counter medicine is not deductible.

LABORATORY EXAMINATIONS AND TESTS

Blood tests
Cardiographs
Metabolism tests
Spinal fluid tests
Sputum tests
Stool examinations
Urine analyses
X-ray examinations

HOSPITAL SERVICES

Anesthetist
Hospital bills
Oxygen mask, tent
Use of operating room
Vaccines
X-ray technician

PREMIUMS FOR MEDICAL CARE POLICIES

See ¶17.6 for how to deduct:
Blue Cross and Blue Shield
Contact lens replacements
Federal Voluntary Medicare (Part B) and Federal Medicare (Part A) by persons not covered by Social Security
Health insurance covering hospital, surgical, and other medical expenses
Membership in medical service cooperative

MISCELLANEOUS

Alcoholic inpatient care costs
Asylum; *see* ¶17.11.
Birth control pills or other birth control items prescribed by your doctor
Braille books—excess cost of braille works over cost of regular editions
Childbirth classes for expectant mother
Clarinet lessons advised by dentist for treatment of tooth defects
Convalescent home—for medical treatment only; *see* ¶17.11.
Drug treatment center—inpatient care costs
Fees paid to health institute where the exercises, rubdowns, etc., taken there are prescribed by a physician as treatments necessary to alleviate a physical or mental defect or illness
Kidney donor’s or possible kidney donor’s expenses
Lead-based paint removal to prevent a child who has had lead poisoning from eating the paint. The cost of repainting the scraped area is not deductible.
Legal fees for guardianship of mentally ill spouse where commitment was necessary for medical treatment
Lifetime care—advance payments made either monthly or as a lump sum under an agreement with a retirement home; *see* ¶17.11.
Nurse’s board and wages, including Social Security taxes paid on wages
Remedial reading for child suffering from dyslexia
Sanitarium and similar institutions; *see* ¶17.11.
School—payments to a special school for a mentally or physically impaired person if the main reason for using the school is its resources for relieving the disability; *see* ¶17.10.
“Seeing-eye” dog and its maintenance
Special school costs for physically and mentally handicapped children; *see* ¶17.10.
Telephone-teletype costs and television adapter for closed caption service for deaf person
Wages of guide for a blind person

NONDEDUCTIBLE MEDICAL EXPENSES

Antiseptic diaper service
Athletic club expenses
Babysitting fees to enable you to make doctor’s visits
Boarding school fees paid for healthy child while parent is recuperating from illness
Bottled water bought to avoid drinking fluoridated city water
Cost of divorce recommended by a psychiatrist
Cost of hotel room suggested for sex therapy
Cost of moving away from airport noise by person suffering a nervous breakdown
Cost of trips prescribed by a doctor for a “change of environment” to boost an ailing person’s morale
Dance lessons advised by a doctor as physical and mental therapy or for the alleviation of varicose veins or arthritis
Divorced spouse’s medical bills; but *see* ¶17.7 to deduct them as alimony.
Domestic help; but *see* ¶17.12 if nursing duties are performed.
Ear piercing
Funeral, cremation, burial, cemetery plot, monument, or mausoleum
Health programs offered by resort hotels, health clubs, and gyms
Illegal operations and drugs
Marriage counseling fees
Massages recommended by physician for general stress reduction
Maternity clothes
Premiums on policies guaranteeing you a specified amount of money each week in the event of hospitalization
Scientology fees
Smoking program to improve your general health is not deductible even if suggested by a doctor.
Special food or beverage substitutes; but *see* ¶17.2.
Tattooing
Toothpaste
Transportation costs of a disabled person to and from work
Travel costs to favorable climate when you can live there permanently
Travel costs to look for a new place to live—on a doctor’s advice
Tuition and travel expenses to send a problem child to a particular school for a beneficial change in environment; *see* ¶17.10.
Weight-loss program to improve general health

How Your Medical Expense Deduction Is Reduced by the 7.5% Limit

If your adjusted gross income is	*Your medical expenses are* $200	$300	$400	$500	$600	$700	$800	$900	$1,000	$1,500	$2,000
	You may deduct										
$2,000	50	150	250	350	450	550	650	750	850	1,350	1,850
3,000	0	75	175	275	375	475	575	675	775	1,275	1,775
4,000	0	0	100	200	300	400	500	600	700	1,200	1,700
5,000	0	0	25	125	225	325	425	525	625	1,125	1,625
6,000	0	0	0	50	150	250	350	450	550	1,050	1,550
7,000	0	0	0	0	75	175	275	375	475	975	1,475
8,000	0	0	0	0	0	100	200	300	400	900	1,400
9,000	0	0	0	0	0	25	125	225	325	825	1,325
10,000	0	0	0	0	0	0	50	150	250	750	1,250
11,000	0	0	0	0	0	0	0	75	175	675	1,175
12,000	0	0	0	0	0	0	0	0	100	600	1,100
13,000	0	0	0	0	0	0	0	0	25	525	1,025
14,000	0	0	0	0	0	0	0	0	0	450	950
15,000	0	0	0	0	0	0	0	0	0	375	875
18,000	0	0	0	0	0	0	0	0	0	150	650
20,000	0	0	0	0	0	0	0	0	0	0	500
25,000	0	0	0	0	0	0	0	0	0	0	125
30,000	0	0	0	0	0	0	0	0	0	0	0
40,000	0	0	0	0	0	0	0	0	0	0	0
50,000	0	0	0	0	0	0	0	0	0	0	0

¶17.3 Nondeductible Medical Expenses

The most common nondeductible medical expense is the cost of over-the-counter medicines and drugs, such as aspirin and other cold remedies. A deduction for over-the-counter medicines is disallowed even if you have a doctor's prescription. Also *see* the checklist on page 269.

Cosmetic Surgery. A medical expense deduction is allowed for cosmetic surgery if it is necessary to improve a disfigurement related to a congenital abnormality, disfiguring disease or an accidental injury.

You may not deduct the cost of cosmetic surgery or other procedures that do not have a medical purpose. Thus, face lifts, hair transplants, electrolysis, and liposuction intended to improve appearance are generally not deductible. In one case, the Tax Court allowed an exotic dancer to claim a depreciation deduction for breast implants essential for her business; *see* ¶19.8.

Exercise, stop-smoking, and weight-reduction programs. If you incur costs for such programs to improve your *general* health, the costs are not deductible even if your doctor has recommended them. However, if your doctor has recommended a program as treatment for a *specific* condition, the IRS has indicated that the cost would be deductible.

¶17.4 Medical Expenses Must Exceed 7.5% of AGI

A wide range of expenses, such as those listed on page 269, qualify as deductible medical expenses. However, you may not be able to claim the deduction because of a percentage floor. You may deduct only expenses exceeding 7.5% of your adjusted gross income (AGI). Adjusted gross income is explained at ¶13.7. For 1996, adjusted gross income is shown on Line 32 of Form 1040.

Married persons filing joint returns figure the 7.5% limit on combined adjusted gross income.

On your 1996 return, you may deduct expenses paid in 1996 for yourself, your spouse, or dependents; *see* ¶17.7. If you borrow to pay medical or dental expenses, you claim the deduction in the year you use the loan proceeds to pay the bill, not in the later year when you repay the loan. If you pay for medical or dental expenses by credit card, the deduction is allowed in the year of the charge.

You may not deduct medical expenses for which you have been reimbursed by insurance or other awards (¶17.5). Furthermore, reimbursement of medical expenses deducted in prior tax years may be taxable income (¶12.8).

EXAMPLE

Frank Ryan's adjusted gross income is $20,000. His unreimbursed medical expenses were $1,000 for medical care, $210 for prescribed drugs and medicines, and $625 for medical insurance premiums. He deducts medical expenses of $335, figured this way:

Unreimbursed expenses and premiums	$1,000
Drugs	210
Total	$1,835
Less: 7.5% of adjusted gross income (7.5% of $20,000)	1,500
Medical expense deduction	$ 335

¶17.5 Reimbursements

Insurance or other reimbursements of your medical costs reduce your medical deductions. Reimbursements for loss of earnings or damages for personal injuries and mental suffering do not. A reimbursement first reduces the medical expense for which it is paid. The excess is then applied to your other deductible medical costs.

EXAMPLE

Gail Hurz paid $800 in medical insurance premiums. She paid doctor and hospital bills totaling $700 and purchased prescription drugs costing $150. Group hospitalization insurance reimbursed $300 for doctors and hospital bills and $25 for medicines and drugs. Her adjusted gross income is $15,000. Her deduction is computed as follows:

Prescription drugs	$ 150
Medical care expenses	700
Premiums	800
Total	$1,650
Less reimbursement	325
	$1,325
Less: 7.5% of $15,000	1,125
Medical expense deduction	$ 200

Personal injury settlements or awards. Generally, a cash settlement recovered in a personal injury suit does not reduce your medical expense deduction. The settlement is not treated as reimbursement of your medical bills. But when part of the settlement is specifically earmarked by a court or by law for payment of hospital bills, the medical expense deduction is reduced.

If you receive a settlement for a personal injury that is partly allocable to future medical expenses, you reduce medical expenses for these injuries by the allocated amount until it is used up.

Fake claims. Medical reimbursements for fake injury claims are treated as taxable income; *see* the following Example.

EXAMPLE

Dodge, with the aid of a "friendly" doctor, arranged to be hospitalized for alleged back injuries and realized over $200,000 from HIP policies. The IRS charged that the insurance proceeds were taxable income. Dodge argued they were tax-free reimbursements of medical costs.

The Tax Court sided with the IRS. The tax-free rules cover the payment of legitimate medical costs. Here there were no legitimate medical costs of actual injuries. Dodge took out the policies in a scam arrangement with the doctor.

Reimbursements in excess of your medical expenses. If you paid the entire premium of the policy, the excess payment is not taxed. If you and your employer each contributed to the policy, you generally have to include in income that part of the excess reimbursement which is attributable to employer premium contributions not included in your gross income.

However, you do not have to report any excess reimbursements that are tax-free payments for permanent disfigurement or loss of bodily functions, as discussed in ¶3.1.

If your employer paid the total cost of the policy and the contributions were not taxed to you, you report as income all of your excess reimbursement, unless it covers payment for permanent injury or disfigurement.

EXAMPLES

1. Henry Knight pays premiums of $240 and $120 for two personal health insurance policies. His total medical expenses are $900. He receives $700 from one insurance company and $500 from the other. The excess reimbursement of $300 ($1,200 – $900) is not taxable because he paid the entire premium on the policy.
2. Lionel Guest's employer paid premiums of $1,800 for two employee health insurance policies covering medical expenses. Guest's medical expenses in one year are $900. He receives $1,200 from the two companies. The entire $300 excess is taxable because Guest's employer paid the total cost of the policy and the contributions were not taxed to him.
3. Kay Brown's employer paid a premium of $1,000 for a group health policy covering Brown, and Brown herself paid $300 for a personal health policy. Her medical expenses are $900. She receives reimbursements of $1,200, $700 under her employer's policy and $500 under her own policy. Brown's reimbursements exceed expenses by $300, but the taxable portion attributed to her employer's premium contribution is $175, computed this way:

Reimbursement allocated to Brown's policy ($500 ÷ $1,200) × $900	$375
Reimbursement allocated to employer's policy ($700 ÷ $1,200) × $900	$525
Taxable excess allocated to employer's policy ($700 – $525)	$175

4. Mike Green's employer paid $1,200 for a health insurance policy but contributed only $450 and deducted $750 from Green's wages. Green also paid $300 for a personal health insurance policy. His medical expenses are $900. He recovered $700 from the employer's policy and $500 from his personal policy. The excess attributable to the employer's policy is $175 (computed as in Example 3 above). However, the taxable portion is only $65.63. Both Green and his employer contributed to the cost of the employer's policy and a further allocation is necessary:

Green's contribution	$ 750
Employer's contribution	450
Total cost of policy	$1,200
Ratio of employer's contribution to annual cost of policy (450 ÷ 1,200, or 37.50%)	
Taxable portion—37.50% of excess reimbursement of $175	$65.63

Reimbursement in a later year may be taxed. If you took a medical expense deduction in one year and are reimbursed for all or part of the expense in a later year, the reimbursement may be taxed in the year received. The reimbursement is generally taxable income to the extent the deduction reduced your tax in the prior year. For further details for figuring taxable income on a recovery of a prior deduction, *see* ¶12.8.

EXAMPLES

1. In 1995, Anna Gurchani had adjusted gross income of $12,000. She claimed itemized deductions which exceeded her allowable standard deduction by $1,000; on her Schedule A, Gurchani listed medical expenses of $1,300. She deducted $700, computed as follows:

Medical expenses	$1,300
Less: 7.5% of $12,000	900
Allowable deduction	$ 400

   In 1996 she collects $300 from insurance, reimbursing part of her 1995 medical expenses. If she had collected that amount in 1995, her medical expense deduction would have been $100. The entire reimbursement of $300 is subject to tax in 1996. It is the amount by which the 1995 deduction of $400 exceeds the deduction of $100 that would have been allowed if the reimbursement had been received in 1995.
2. Same facts as in Example 1 above, but Anna did not deduct medical expenses in 1995 because she did not itemize deductions. The reimbursement in 1996 is not taxable.

¶17.6 Premiums of Medical Care Policies

You may deduct as medical expenses premiums paid for medical care policies covering yourself, your spouse, or dependents. There is no separate deduction for health insurance premiums. All qualifying premiums are treated as medical expenses subject to the overall 7.5% limit. Include premium for Medicare Part B supplemental insurance. Payment for coverage under Medicare (Part A) is deductible by those over age 65 who are not covered by Social Security. Deductions may be claimed for membership payments in associations furnishing cooperative or free-choice medical services, group hospitalization, or clinical care policies, including HMOs (health maintenance organizations) and medical care premiums paid to colleges as part of a tuition bill, if the amount is separately stated in the bill.

Deduct premiums for health insurance providing reimbursements for hospital, surgical, drug costs, and other medical expenses. Also deductible are premiums paid for contact lens replacement and premiums on policies providing solely for indemnity for hospital and surgical expenses.

Premiums paid before you reach age 65 for medical care insurance for protection after you reach age 65 are deductible in the year paid if they are payable on a level payment basis under the contract (1) for a period of 10 years or more; or (2) until the year you reach age 65 (but in no case for a period of less than five years).

Starting in 1997, premiums for qualifying long-term care policies are deductible; *see* ¶17.15.

Nondeductible premiums. You may *not* deduct premiums for a policy guaranteeing you a specified amount each week (not to exceed a specified number of weeks) in the event you are hospitalized. Also, no deduction may be claimed for premiums paid for a policy which compensates you for loss of earnings while ill or injured, or for loss of life, limb, or sight. If your policy covers both medical care and loss of income or loss of life, limb, or sight, no part of the premium is deductible unless (1) the contract or separate statement from the insurance company states what part of the premium is allocated to medical care; and (2) the premium allocated to medical care is reasonable.

You may not deduct part of car insurance premiums for medical insurance coverage for persons injured by or in your car.

Self-Employed Deduction of 30%. If you were self-employed in 1996, you may claim a special deduction on Form 1040, Line 26, for 30% of health insurance premiums paid in 1996 for yourself, your spouse, and your dependents. The deduction is also allowed if you received wages from an S corporation in which you were more than a 2% shareholder.

The 30% deduction may not be claimed for any month during 1996 that you were covered under an employer's subsidized health plan, including a plan of your spouse's employer. Also, the deduction may not exceed your net earnings from the business under which the health premiums are paid.

Any balance of premiums not deductible under the special 30% rule may be claimed as an itemized medical expense subject to the 7.5% income floor (¶17.4).

In 1997, the deduction limit will jump to 40%, and to 45% in 1998.

¶17.7 Expenses of Your Spouse and Dependents

You may deduct as medical expenses your payments of medical bills for your spouse if you were married *either* at the time the expenses were incurred or at the time the bills were paid. That is, you may deduct your payment of your spouse's medical bills even though you are divorced or widowed, if, at the time the expenses were incurred, you were married. Furthermore, if your spouse incurred medical expenses before you married and you pay the bills after you marry, you may deduct the expense.

Expenses of children and other dependents. You may deduct your payment of medical bills for your children or other dependents, subject to the 7.5% floor at ¶17.4. You may deduct the expenses of a person who was your dependent either at the time the medical services were provided or at the time you paid the expenses. In determining dependent status for medical expense purposes, you may disregard two of the regular tests listed at ¶22.1 for claiming an exemption for a dependent. You may deduct the medical costs of a person who qualifies as your dependent under the relationship test (Test 1), the support test (Test 3), and the citizen or resident test (Test 4). The gross income test (Test 2) and the joint return test (Test 5) do not have to be met. *See* Examples 4–6 below.

A child may not deduct medical expenses paid with his or her parent's welfare payments; *see* Example 7 below.

Divorced and separated parents. You may be able to deduct your payment of your child's medical costs, even though your ex-spouse is entitled to claim the child as a dependent. For purposes of the medical deduction, the child is considered to be the dependent of *both* parents if (1) they are divorced or legally separated under a court agreement, separated under a written agreement, or married but living apart during the last six months of 1996; (2) the child was in the custody of one or both parents for more than half of 1996; and (3) more than half of the child's 1996 support was provided by both parents.

EXAMPLES

1. Your spouse has doctor bills covering an operation performed in 1995, before you were married. You married in 1996. You pay those bills in 1996. You may claim a 1996 medical expense deduction for your payment.
2. In October 1995, your spouse had dental work done. In February 1996, you are divorced; in April 1996, you pay your former spouse's dental bills. You may deduct the payment on your 1996 tax return.
3. In 1996, you pay medical expenses for your spouse who died in 1995. You remarry in 1996. On a 1996 joint return filed with your new spouse, you may deduct your payment of your deceased spouse's medical expenses.
4. You contribute more than half of your married son's support, including a payment of a medical expense of $800. Because he filed a joint return with his wife, you may not claim him as a dependent (¶22.13). But you still may deduct your payment of the $800 medical expense since you contributed more than half of his support.
5. Your mother underwent an operation in November 1995. You paid for the operation in February 1996. You may deduct the cost of the operation in 1996 if you furnished more than one-half of your mother's support in either 1995 or 1996.
6. Same facts as Example 5, except your mother is a citizen and resident of Italy. You may not deduct the cost of the operation. She is not a U.S. citizen or a resident of the United States, Canada, or Mexico (*see* ¶22.12).
7. A son is the legal guardian of his mother who is mentally incompetent. As guardian, he received his mother's state welfare and Social Security benefits, which he deposited in his personal bank account and used to pay part of his mother's medical expenses. On his tax return, he claimed a deduction for the total medical expenses paid on behalf of his mother. The court held that he could deduct only medical expenses in excess of the amounts received as welfare and Social Security payments. The benefits, to the extent used to pay medical expenses, represented the mother's payments in her own behalf.

Adopted children. You may deduct medical expenses of an adopted child if you may claim the child as a dependent either when the medical services are rendered or when you pay the expenses. An adopted child may be claimed as a dependent when a court has approved the adoption. In the absence of a court decree, the child is your dependent if he or she was placed in your home by an authorized agency and was a member of your household the rest of the year; *see* ¶22.3. If he or she has not been placed in your custody by an authorized agency, you have to show that the child lived in your home for the entire year.

If you reimburse an adoption agency for medical expenses it paid under an agreement with you, you are considered to have paid the expenses. But reimbursement of expenses incurred and paid before adoption negotiations does not qualify them as your medical expenses and you may not deduct them.

You may not deduct medical expenses for services rendered to the natural mother of the child you adopt.

Multiple support agreements. You may be able to deduct your payment of a relative's medical expenses although you do not contribute more than one-half of his or her support. You must meet the tests for a multiple support agreement; *see* ¶22.10. If your relative has a gross income of $2,500 or more, you may still deduct your payment of medical expenses provided the other tests for multiple support are met.

You may deduct only the amount you actually pay for the relative's medical expenses. If you are reimbursed by others who signed the multiple support agreement, you must reduce your deduction by the amount of reimbursement.

EXAMPLE

Ingrid Fromm and her brother and sister share equally in the support of their mother. Part of their mother's support includes medical expenses. Should the three of them share in the payment of the bills or should only one of them pay the bills? The answer: Payment should be made by the person who may claim the mother as a dependent under a multiple support agreement. Only that person may deduct the payment. If Ingrid is going to claim her as an exemption, she should pay the bill. She may deduct the payment although she did not contribute more than half of her mother's support. If her brother and sister reimburse her for part of the bill, she must reduce her medical deduction by the amount of the reimbursement. Neither Ingrid's brother nor her sister may deduct this share. Thus, a deduction is lost for these amounts.

¶17.8 Decedent's Medical Expenses

If you pay the medical expenses of your deceased spouse or dependent, you may claim them as medical expenses in the year paid, whether that is before or after the person's death; *see* ¶17.7.

If the executor or administrator of the estate pays the decedent's medical expenses within one year after the date of death, an election may be made to treat the expenses as if the deceased had paid them in the year the medical services were provided. The executor or administrator may file an amended return for the year the services were provided and claim them as a medical deduction for that year, assuming the period for filing the amended return (¶38.1) has not passed.

If the election is made to claim the expenses as an income tax deduction, they may not be claimed as a deduction on the estate tax return. The executor must file a statement with the decedent's income tax return that the expenses have not been deducted on the estate tax return and the estate waives its right to deduct them for estate tax purposes.

If medical expenses are claimed as an income tax deduction, the portion of the expenses that are below the 7.5% floor, and, therefore, not deductible, may not be deducted on the estate tax return. Although the expenses were not actually deducted, the IRS considers them to be part of the overall income tax deduction.

EXAMPLE

Oscar Reyes incurred medical expenses of $500 in 1995 and $300 in 1996. He died June 1, 1996, without having paid these expenses. He had already filed his 1995 return before the due date. In August 1996, his executor pays the $800 in medical expenses. He may file an amended return for 1995, claim a medical expense deduction for the $500, and get a refund for the increased deductions. He may claim the remaining $300 as a medical expense deduction on Reyes' final return for 1996.

¶17.9 Travel Costs May Be Medical Deductions

You may deduct the cost of travel to a place where you receive medical treatment or which is prescribed as a place that will help relieve a specific chronic ailment. Trips to and from a doctor's office are the most common type of deductible travel expense.

The amount of the deduction is limited to the cost of transportation, such as the cost of operating a car or fares for public transportation. If you use your automobile, you may deduct a flat rate of 10¢ a mile and, in addition, you may deduct parking fees and tolls. If, however, auto expenses exceed this standard mileage rate, you may deduct your actual out-of-pocket costs for gas, oil, repairs, tolls, and parking fees. Do not include depreciation, general maintenance, or car insurance.

EXAMPLE

You drive your car to a doctor's office for treatment. You made 40 such round trips of 25 miles each. As the total mileage is 1,000, you claim $100 (1,000 × 10¢) as medical expenses. If you incurred tolls or parking fees during the trips, you add these expenses to the deduction.

Lodging expenses. Your lodging expenses while away from home are not deductible as medical expenses unless the trip is primarily to receive treatment from a doctor in a licensed hospital, hospital-related out-patient facility, or a facility equivalent to a hospital. Food expenses are not deductible.

EXAMPLE

Polyak spent the winter in Florida on the advice of her doctor to alleviate a chronic heart and lung condition. While in Florida, she stayed in a rented trailer that cost $1,426. She saw a physician for treatment of an infection and to renew medications. She deducted the trailer costs as a medical deduction, which the IRS and Tax Court disallowed. Although her Florida trip was primarily for mitigating her condition, she did not travel to receive medical care from a physician in a licensed hospital or related out-patient facility. The medical care was routine and incidental to her travel to Florida. Her deduction for transportation costs to Florida was not contested by the IRS, which conceded that the trip was primarily for and essential to her health.

The deduction for lodging while receiving treatment at a licensed hospital, outpatient clinic, or hospital-equivalent facility is limited to $50 per night per person. For example, the limit is $100 if a parent travels with a sick child. The IRS ruled that the $50 allowance could be claimed by a parent for a six-week hotel stay while her eight-year-old daughter was treated in a nearby hospital for serious injuries received in an automobile accident. The mother's presence was necessary so that she could sign release forms.

DEDUCTIBLE TRANSPORTATION COSTS—

Examples of travel costs which have been allowed as medical deductions by rulings or court decisions are:

- Nurse's fare if nurse is required on trip.
- Parent's fare if parent is needed to accompany child who requires medical care.
- Parent's fare to visit his child at an institution where the visits are prescribed by a doctor.
- Trip to visit specialist in another city.
- Airplane fare to a distant city in which a patient used to live to have a checkup by a family doctor living there. That he could have received the same examination in the city in which he presently lived did not bar his deduction.
- Trip to escape a climate that is bad for a specific condition. For example, the cost of a trip from a northern state to Florida during the winter on the advice of a doctor to relieve a chronic heart condition is deductible. The cost of a trip made solely to improve post-operative condition by a person recovering from a throat operation was ruled deductible.
- Travel to an Alcoholics Anonymous club meeting if membership in the group has been advised by a doctor.
- Disabled veteran's commuting expenses where a doctor prescribed work and driving as therapy.
- Wife's trip to provide nursing care for an ailing husband in a distant city. The trip was ordered by her husband's doctor as a necessity.
- Driving prescribed as therapy.
- Travel costs of kidney transplant donor or prospective donor.

NONDEDUCTIBLE TRANSPORTATION COSTS—

- Trip for the general improvement of your health.
- Traveling to areas of favorable climates during the year for general health reasons, rather than living permanently in a locality suitable for your health.
- Meals while on a trip for medical treatment—even if cost of transportation is a valid medical cost. However, a court has allowed the deduction of the extra cost of specially prepared food.
- Trip to get "spiritual" rather than medical aid. For example, cost of a trip to the Shrine of Our Lady of Lourdes is not deductible.
- Moving a family to a climate more suitable to an ill mother's condition. Only the mother's travel costs are deductible.
- Moving household furnishings to area advised by physician.
- Operating an auto or special vehicle to go to work because of disabled condition. The cost of wheelchair, autoette, or special auto devices for handicapped persons is deductible.
- Convalescence cruise advised by a doctor for a patient recovering from pneumonia.
- Loss on sale of car bought for medical travel.
- Medical seminar cruise taken by patient whose condition was reviewed by physicians taking the cruise.

¶17.10 Schooling for the Mentally or Physically Handicapped

You may deduct as medical expenses the costs of sending a mentally or physically handicapped person to a special school or institution to overcome or alleviate his or her handicap. Such costs may cover:

- Teaching of braille or lip reading.
- Training, caring for, supervising, and treating a mentally retarded person.
- Cost of meals and lodgings, if boarding is required at the school.
- Costs of regular education courses also taught at the school, provided they are incidental to the special courses and services furnished by the school.

The parent of a child with psychological problems may deduct only that part of a private school fee directly related to psychological aid given to the child.

The fact that a particular school or camp is recommended for an emotionally disturbed child by a psychiatrist will not qualify the tuition as a deduction if the school or camp has no special program geared to the child's specific personal problem. However, you may deduct the costs of maintaining a mentally retarded person in a home specially selected to meet the standards set by a psychiatrist to aid in an adjustment from life in a mental hospital to community living.

Payment for future medical care expenses is deductible if immediate payment is required by contract.

EXAMPLES

1. An emotionally disturbed child was sent to a private school maintaining a staff of three psychologists. His father deducted the school fee of $6,270 as a medical expense. The IRS disallowed the amount, claiming that the child, who was neither mentally retarded nor handicapped, was sent to school primarily for an education. The Tax Court allowed the father to deduct $3,000 covering the psychological treatment.
2. A retarded boy had been excluded from several schools for the mentally handicapped because he needed close attention. The director of a military academy had extensive experience in training young boys. Although it was not the usual practice of the academy to enroll mentally handicapped children, the director accepted the boy on a day-to-day basis as a personal challenge. The Tax Court held that the cost of both tuition and transportation to bring the boy to and from the school were deductible medical expenses. The primary purpose of the training given the boy was not ordinary education but remedial training designed to overcome his handicap. But note that, in other cases, a deduction for tuition of a military school to which a child was sent in order to remove him from a tense family environment, and the cost of a blind boy's attendance at a regular private school which made a special effort to accommodate his braille equipment, were disallowed.

¶17.11 Senior Citizen Care Facilities

A payment for meals and lodging to a nursing home, convalescent home, home for the aged, or sanitarium is a deductible medical expense if the patient is confined for medical treatment.

If you cannot prove that the patient entered the home for medical care (which would permit a deduction for meals and lodging in addition to medical costs), you may nevertheless deduct that part of the cost covering actual medical and nursing care.

In an unusual case, a court allowed a medical expense deduction for apartment rent of an aged parent.

EXAMPLE

A doctor recommended to Ungar that his 90-year-old mother, convalescing from a brain hemorrhage, could receive better care at less expense in accommodations away from a hospital. A two-room apartment was rented, hospital equipment installed, and nurses engaged for seven months. The rent totaled $1,400. Ungar's sister, who worked in her husband's shoe store, nursed her mother for six weeks. Ungar paid the wages of a clerk who was hired to substitute for his sister in the store. Ungar deducted both the rent and wages as medical expenses. The IRS disallowed them; a Tax Court reversed the IRS' decision. The apartment rent was no less a medical expense than the cost of a hospital room. As for the clerk's wages, they too were deductible medical costs. The clerk was hired specifically to allow the daughter to nurse her mother, thereby avoiding the larger, though more direct, medical expense of hiring a nurse.

Establishing medical purpose. The following facts are helpful in establishing the full deductibility of payments to a nursing home, convalescent home, home for the aged, or sanitarium:

- The patient entered the institution on the direction or suggestion of a doctor.
- Attendance or treatment at the institution had a direct therapeutic effect on the condition suffered by the patient.
- The attendance at the institution was for a specific ailment rather than for a "general" health condition. Simply showing that the patient suffers from an ailment is not sufficient proof that he or she is in the home for treatment.

Payment for future lifetime care. Generally, no deduction is allowed for prepayment of medical expenses for services to be performed in a later taxable year. However, in the Examples below, the IRS allowed a deduction where there was a current obligation to pay.

EXAMPLES

1. A 78-year-old man entered into an agreement with a retirement home. For a lump-sum payment, the home agreed to provide lifetime care, including medical care, medicine, and hospitalization. The lifetime care fee was calculated without regard to fees received from other patients and was not insurance. The home allocated 30% of the lump-sum payment to medical expenses based on its prior experience. The IRS holds that this part of the payment is deductible in the year paid. It holds that the legal obligation to pay the medical expenses was incurred at the time the lump-sum payment was made, even though medical services would not be performed until a future time, if at all. Should any portion of the lump-sum payment be refunded, that part attributable to the deducted amount must be reported as income; *see* ¶12.8.
2. Parents contracted with an institution to care for their handicapped child after their death. The contract provided for payments as follows: 20% on signing, 10% within 12 months, 10% within 24 months, and the balance when the child enters. Payment of specified amounts at specified intervals was a condition imposed by the institution for its agreement to accept the child for lifetime care. Since the obligation to pay was incurred at the time payments were made, they are deductible as medical expenses, although the medical services were not to be performed until a future time, if at all.
3. A couple entered a retirement home which would provide them with accommodations, meals, and medical care for life. They paid a founder's fee of $40,000 and a monthly fee of $800. If they leave the home, they may get a refund of a portion of the founder's fee. Fifteen percent of the monthly fee and 10% of the founder's fee will be used for medical care and 5% of the founder's fee will be used for construction of a health facility. On the basis of these figures, the couple may deduct as medical costs 10% of the founder's fee and 15% of the monthly fee. However, the portion of the founder's fee for the possible health facility does not qualify as a medical expense. Finally, any refund of the founder's fee received in a later year may be income to the extent medical deductions were previously claimed for the fees.

¶17.12 Nurses' Wages

The costs of a nurse attending an ill person are deductible. Costs include any Social Security (FICA) tax paid by you. You may deduct the expenses of a nurse who is not registered or licensed so long as he or she provides you with medical services. Medical services include giving medications, changing dressings, and bathing and grooming the patient. If the nurse also performs domestic services, deduct only that part of the pay attributable to medical services for the patient.

The cost of an attendant's meals is included in your medical expenses. Divide total food costs among the household members to determine the attendant's share.

Costs eligible for tax credit. If, in order to work, you pay a nurse to look after a physically or mentally disabled dependent, you may be able to claim a credit for all or part of the nurse's wages as a dependent care expense. You may not, however, claim both a credit and a medical expense deduction. First, you claim the nurse's wages as a dependent care cost. If not all of the wages are allowed as care costs because of the expense limits (Chapter 25), the remaining balance is deductible as a medical expense.

The salary of a clerk hired specifically to relieve a wife from her husband's store in order to care for her ill mother was allowed as a medical expense; *see* the Ungar Example in ¶17.11.

EXAMPLES

1. Dodge's wife was arthritic. He was advised by her doctor to have someone take care of her to prevent her from falling. He moved her to his daughter's home and paid the daughter to care for her mother. He deducted the payments to his daughter. The IRS disallowed the deduction, claiming that the daughter was not a trained nurse. The Tax Court allowed that part of the deduction specifically attributed to nursing aid. Whether a medical service has been rendered depends on the nature of the services rendered, not on the qualifications or title of the person who renders them. Here, the daughter's services, following the doctor's advice, qualify as medical care.
2. An attendant hired by a quadriplegic performs household duties, in addition to caring for his medical and personal needs. The quadriplegic pays him wages and also provides food and lodging. According to the IRS, a medical expense deduction is allowable only for that portion of the wages attributable to medical and personal care. The wages are apportioned on the basis of time spent performing nursing-type services and time spent performing household duties. The same allocation is used to determine the portion of the cost of the attendant's meals which are deductible as a medical expense. However, the attendant's lodging is not deductible as a medical expense, unless the quadriplegic shows additional expenditures directly attributable to lodging the attendant, such as paying increased rent for an apartment with another bedroom for the attendant.

¶17.13 Home Improvements as Medical Expenses

A disease or ailment may require the construction of special equipment or facilities in a home: A heart patient may need an elevator to carry him or her upstairs; a polio patient, a pool; and an asthmatic patient, an air cleaning system.

You may deduct the full cost of minor equipment installed for a medical reason if it does not increase the value of your property, as, for example, the cost of a detachable window air conditioner. Where equipment increases the value of your property, you may generally take a medical deduction only to the extent that the cost of the equipment exceeds the increase in the value of the property. This increased-value test does *not* apply to certain structural changes to a residence made by a handicapped person, as discussed at the end of this section. If the equipment does not increase the value of the property, its entire cost is deductible, even though it is permanently fixed to the property.

EXAMPLE

Mike Gerard's daughter suffered from cystic fibrosis. While there is no known cure for the disease, doctors attempt to prolong life by preventing pulmonary infection. One approach is to maintain a constant temperature and high humidity. A doctor recommended that Gerard install a central air-conditioning unit in his home for his daughter. It cost $1,300 and increased the value of his home by $800. The $500 balance was a deductible medical expense.

Deducting cost of swimming pool. If swimming is prescribed as physical therapy, the cost of constructing a home swimming pool may be partly deductible as a medical expense but only to the extent the cost exceeds the increase in value to the house. However, the IRS is likely to question any deduction because of the possibility that the pool may be used for recreation. If you can show that the pool is specially equipped to alleviate your condition and is not generally suited for recreation, the IRS will allow the deduction unless the expense is considered to be "lavish or extravagant." For example, the IRS allowed a deduction for a pool constructed by an osteoarthritis patient. His physician prescribed swimming several times a day as treatment. He built an indoor lap pool with specially designed stairs and a hydrotherapy device. Given these features, the IRS concluded that the pool was specially designed to provide medical treatment.

In one case the IRS tried to limit the cost of a luxury indoor pool built for therapeutic reasons to the least expensive construction. The Tax Court rejected the IRS position, holding that a medical expense is not to be limited to the cheapest form of treatment; on appeal, the IRS position was adopted.

If, instead of building a pool, you buy a home with a pool, can you deduct the part of the purchase price allocated to the pool? The Tax Court said no. The purchase price of the house includes the fair market value of the pool. Therefore, there is no extra cost above the increase in the home's value which would support a medical expense deduction.

The operating costs of an indoor pool were allowed by the Tax Court as a deduction to an emphysema sufferer.

A deduction is barred where the primary purpose of the improvement is for personal convenience rather than medical necessity.

EXAMPLES

1. Ken Cherry was advised by his doctor to swim to relieve his severe emphysema and bronchitis. He could not swim at local health spas; they did not open early enough or stay open late enough to allow him to swim before or after work. His home was too small for a pool. He bought a lot and built a new house with an indoor pool. He used the pool several times a day, and swimming improved his condition; if he did not swim, his symptoms returned. Cherry deducted pool operating costs of $4,000 for fuel, electricity, insurance, and repairs. The IRS disallowed the deductions, claiming that the pool was used for personal recreation. Besides, it did not have special medical equipment. The Tax Court allowed the deduction. Cherry built the pool to swim in order to exercise his lungs. That there was no special equipment is irrelevant; Cherry did not need special ramps, railings, a shallow floor, or whirlpool. Finally, his family rarely used the pool.
2. Doug Haines broke his leg in a skiing accident and underwent various forms of physical therapy, including swimming. To aid his recovery, his physician recommended that he install a swimming pool at his home. The Tax Court agreed with the IRS that the cost of the pool was not deductible. Although swimming was beneficial to his condition, he needed special therapy only for a limited period of time, and he could have gotten it at less cost at a nearby public pool. Finally, because of weather conditions, the pool could not be used for about half of the year.

Cost of maintaining and operating improvement. The expense of maintaining and operating equipment installed for medical reasons may be claimed as a medical expense, even if the cost of the equipment and its installation is not deductible under the rules in this section.

Handicapped persons. The increased-value test does not apply to a handicapped person who makes structural changes to a residence such as adding ramps, modifying doorways and stairways, installing railings and support bars, and altering cabinets, outlets, fixtures, and warning systems. Such improvements are treated for medical deduction purposes as not increasing the value of the house. Lifts, but not elevators, also are in this category. The full cost of such improvements is added to other deductible expenses and the total is deductible to the extent that it exceeds the 7.5% AGI floor.

¶17.14 Costs Deductible as Business Expenses

The following Examples illustrate cases in which expenses are deductible as business expenses rather than as medical expenses. Claiming a business deduction is preferable because the deduction is not subject to the 7.5% adjusted gross income floor.

Costs of a checkup required by your employer are business expenses and are not subject to the 7.5% AGI floor.

EXAMPLE

An airline pilot is required by his company to take a semi-annual physical exam at his own expense. If he fails to produce a resultant certificate of good health, he is subject to discharge. The cost of such checkups certifying physical fitness for a job is an ordinary and necessary business expense. If the doctor prescribes a treatment or further examinations to maintain the pilot's physical condition, the cost of these subsequent treatments or examinations may be deducted only as medical expenses, even though they are needed to maintain the physical standards required by the job. Thus, a professional singer who consults a throat specialist may not deduct the fee as a business expense. The fee is a medical expense subject to the 7.5% AGI floor.

The Tax Court allowed a licensed social worker working as a therapist to deduct psychoanalysis costs as an education expense.

Handicapped persons. Some expenses incurred by a physically handicapped person due to his or her handicap may be deductible as business expenses rather than as medical expenses. A business expense deduction may be allowed if the expense is necessary for you to satisfactorily perform your job and is not required or used, except incidentally, for personal purposes.

If you are self-employed, claim the deduction on Schedule C.

If you are an employee, the expenses are listed on Form 2106 and if not reimbursed, entered on Schedule A. The expenses are a fully deductible miscellaneous itemized deduction; the 2% AGI floor does *not* apply.

EXAMPLES

1. A professor is paralyzed from the waist down and confined to a wheelchair. When he attends out-of-town business meetings, he has his wife, a friend, or a colleague accompany him to help him with baggage, stairs, narrow doors, and to sit with him on airplanes when airlines will not allow wheelchair passengers without an attendant. While he does not pay them a salary, he does pay their travel costs. He may deduct these costs as business expenses. They are incurred solely because of his occupation.
2. An attorney uses prostheses due to bilateral amputation of his legs and takes medication several times a day for other ailments. On both personal and business trips, his wife or a neighbor accompanies him to help him travel and receive medication. He may deduct the out-of-town expenses paid for his neighbor only as a medical expense. The neighbor's services are not business expenses because assistance in personal activities is regularly provided. When his wife accompanies him, he may deduct her transportation costs as a medical expense; her food and lodging are nondeductible ordinary living expenses.

¶17.15 Long-Term Care Insurance and Services

A new law provides limited tax breaks starting in 1997 for certain long-term health care expenses and benefits under qualifying policies.

Premiums for long-term care policies. Depending on your age, all or part of your premium payments after 1996 for a qualified long-term care policy may be included as deductible medical expenses, subject to the 7.5% adjusted gross income floor. To qualify, the policy must provide for long-term care services for the chronically ill; these tests are discussed in the next paragraph. The amount of the deductible premium depends on your age at the end of the year. For 1997, the maximum annual deductible premium amounts are: $200 if you are age 40 or younger at the end of 1997; $375 for those age 41 through 50; $750 for those age 51 through 60; $2,000 for those age 61 through 70; and $2,500 for those over age 70. These limits may be increased after 1997 by an inflation factor.

Payments for long-term care services. Starting in 1997, you may deduct as medical expenses (subject to the 7.5% income floor) your unreimbursed expenses for qualifying long-term care services that you require because you are "chronically ill" as defined in the new law, or because your spouse or dependent is chronically ill. A chronically ill person is someone who has been certified by a licensed health care practitioner within the preceding 12 months as being unable to perform for a period of at least 90 days at least two of the following activities without substantial assistance: eating, toileting, dressing, bathing, continence, or transferring. Also qualifying as chronically ill is someone who requires substantial supervision because of severe cognitive impairment, such as from Alzheimer's disease.

Qualifying long-term care services for a chronically ill individual are broadly defined as necessary diagnostic, preventive, therapeutic, curing, treating, mitigation, and rehabilitative services, and also maintenance or personal care services. The services must be provided under a plan of care prescribed by a licensed health care practitioner, who may be a physician, a registered nurse, a licensed social worker, or other individual meeting Treasury requirements. Services provided by a spouse or relative are deductible only if that person is a licensed professional; services provided by a related corporation or partnership do not qualify.

Benefits received from a qualifying long-term care policy. Benefits received after 1996 from a qualifying long-term care policy issued after 1996 or from a pre-1997 policy that met state law requirements are tax free unless an annual limit for per diem type contracts applies. Payments under per diem–type plans that pay a flat amount without regard to actual long-term care expenses are tax free up to the greater of $175 per day ($63,875 annually) or the actual annual costs for long-term care services, minus reimburse-

ments for long-term care expenses. For years after 1997, the $175 limit may be increased for inflation.

Long-term coverage under employer plans. Starting in 1997, employees are not taxed on employer-provided coverage under a qualifying long-term care policy unless the coverage is provided through a cafeteria plan (¶3.13). Tax-free reimbursements may not be made for long-term care services under a flexible spending arrangement (¶3.14). Benefits under per diem–type contracts are subject to the $175 limit discussed above.

Caution: If you are planning to buy long-term care insurance, make sure that you get a disclosure statement from the insurance company that states that the policy is a qualified long-term care contract under the new law.

¶17.16 Medical Savings Accounts (MSAs)

Medical Savings Accounts, or MSAs, are intended to meet medical costs not covered by a high-deductible health plan. MSAs may be offered in 1997 only by employers who on average had no more than 50 employees in either of the two preceding years and who provide high-deductible health plans. The annual deductible must be between $1,500 and $2,250 for individuals and between $3,000 and $4,500 for families. An employee covered by an employer plan is not taxed on employer MSA contributions of up to 65% of the deductible for single coverage or 75% of the deductible for family coverage. Earnings in an MSA accumulate tax free. Distributions are tax free if used to pay unreimbursed medical expenses of an eligible person with high deductible plan coverage. Distributions not used for such medical expenses are subject to a regular tax, and, in addition, a 15% penalty, unless made after reaching age 65 or becoming disabled.

In 1997, a self-employed person may set up an MSA to supplement a high-deductible policy and deduct payments to an MSA up to the limits applied to employer plans. Contributions within these limits are deductible whether or not itemized deductions are claimed and the deduction is in addition to any deduction claimed for health insurance premiums claimed under the rules at ¶17.6.